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Proposed Amendments Western Grain Stabilization Act

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AMENDMENTS TO THE WESTERN GRAIN STABILIZATION ACT

OBJECT:

This paper reviews; (1) the contribution of the Western Grain Stabilization Program (W.G.S.P.) to the stability of the prairie grain sector, (2) producers' concerns about the Program, and (3) indicators of the current financial situation in the prairie grain sector; and, presents options which would make the Program more sensitive to the current financial needs of Western Canadian grain farmers.

ISSUE:

There are two principal issues giving rise to current concerns over whether the W.G.S.P. is meeting the needs of prairie grain producers.

1. There is growing concern by prairie grain producers that the W.G.S.P. is not responding to their current financial circumstances because no payouts have been made since 1978.

2. A related issue is a perception that the W.G.S.P. is not working properly since the Western Grain Stabilization Fund balance has become large in relation to likely payouts.

BACKGROUND:

The W.G.S.P. marked a new development in approaches to price or income stabilization for agricultural commodities. Stabilization for most agricultural commodities had previously been totally focussed on providing price support. For many commodities the volume marketed is relatively stable and thus variation in income relates closely to variation in price. In the case of grain, volume of sales is variable due to fluctuations in international market demand and in the 1970's because of transportation constraints, factors which are both beyond the control of grain producers.

Thus the concept of net cash flow stabilization plan was developed in recognition that grain producers were subject to the risks of price, volume variability and cost increases. When a grain stabilization plan was first proposed by the Task Force on Canadian Agriculture in the 1970's, the concept of a price support plan was put forward. However farmers at that time were faced with large carryover stocks and export volumes had declined from levels reached in the mid 1960's. A plan which supported

price only was not acceptable to many producers. Subsequently in 1971 a Grain Receipts Stabilization program was proposed which would have supported gross receipts at the level of the previous five year average. This plan was criticized for not including costs and in 1974 the net cash flow concept was proposed. This approach was broadly endorsed by farm groups and individual producers as evidenced by the proportion of eligible producers who adopted the program when it was introduced in 1976 and who voluntarily remained in during the introductory period.

The general objective of the W.G.S.P. is to protect grain producers in the Canadian Wheat Board designated area against unexpected declines in net returns due to short term price fluctuations, reduced marketings and increased production costs. The program protects actual producers of grain within the Canadian Wheat Board region collectively, and makes no provision to ensure stable returns for individual producers. The program is intended to be consistent with a market and growth oriented agricultural policy and to make a major contribution to income stability and efficiency in resource allocation in Canadian agriculture with benefits to the economy as a whole.

The grain industry is central to the Prairie economy and has a significant impact on the Canadian economy. It is an important source of revenue and employment not only for farmers, but also for the many related industries which provide production inputs, or which are involved in the various aspects of processing, transportation and marketing. Grain and oilseed exports consistently represent about 73 percent of the value of all agricultural exports and about 8 percent of total Canadian exports.

Under the W.G.S.P., net cash flow for each calendar year is supported at the average of the net cash flow in the previous five years. Net cash flow is the difference between gross grain receipts and cash expenses, with adjustments for costs related to grain not sold, and receipts that are not eligible for coverage under the program.

In any year in which net cash flow falls below the previous five year average, the difference, adjusted for the level of producer participation in the program, is paid to producers. Each participating producer shares in any payout on the basis of the amount of levy paid in that year and the two previous years in proportion to the levies paid by all participating producers in those three years.

Payouts are made from the Western Grain Stabilization Fund. Producers and the Federal Government contribute levies to the Fund. Participating producers during the period 1976 through

1983 contributed at the rate of two percent of eligible gross grain receipts. The Federal Government contributed an amount equal to four percent of eligible gross grain receipts. The Federal Government also pays interest on the balance in the Western Grain Stabilization Fund.

Payouts to producers from the stabilization fund have been made for 1977 and 1978 only and totaled $368 million. With no payouts in subsequent years the fund balance reached about $885 million at the end of 1983. As a result of the fund balance, the provision of the W.G.S. Act regarding reduction of producer levies to one and one-half percent and the Federal Government contribution to three and one-half percent became effective on January 1, 1984.

The W.G.S.P. did not make a payout for 1982 despite a decline in grain prices. Current projections indicate no payout for 1983 since net cash flow is still above the previous five year average. The net cash flow in 1982 was the second highest (after 1981) since the program began, and the projected net cash flow for 1983 is similar to that for 1982. Currently gross receipts for 1983 are projected at $6.15 billion, five percent above the 1982 level. The 1983 gross receipts reflect a nine percent increase in the volume of marketings which has more than offset the three percent decline in the average price of grains and oilseeds.

There is however a perception in the prairie grain sector that the number of farmers experiencing financial difficulties is increasing. There are a number of indicators, including bankruptcies, farm debt, farm loans in arrears, farm machinery purchases, and lower land prices which support this perception.

The low grain prices which have prevailed in the past year following significant cost increases in the late 1970's have reinforced this perception. There is criticism by producers that the W.G.S.P. is not providing assistance when it is needed. Current market expectations indicate continuing pressure on grain prices. Markets are extremely competitive and it will be difficult to maintain export volume.

Production costs have increased each year since the program started. The W.G.S. program includes only cash costs. The remaining net cash flow should cover depreciation, debt servicing and provide a return to family and operator labour and management as well as a return to equity. Net cash flow when expressed as a proportion of grain receipts has trended downwards since the early 1970's. Thus a smaller proportion of total

receipts remains after cash expenses are paid to meet these other expenditures. Some of these other costs such as interest on indebtedness have increased sharply in recent years. Interest on indebtedness accounted for 13.1% of total operating expenses in 1976 and accounted for a high of 18.7% in 1981, but has declined subsequently. Additionally this has some implications for the amount of funding required for the program.

A review of the Western Grain Stabilization Act was conducted in 1978, as required by the Act. The W.G.S.P. was considered to be working properly but that review concluded that a longer period of observation was required for an effective evaluation. A major review of the W.G.S.P. initiated as part of the Government review of all loss compensation/income stabilization programs, and also in response to a request for a "funding review" of the program has recently been completed. The review assessed the impacts and effectiveness of the W.G.S.P within the scope of the existing legislation and examined alternatives and concerns which were raised in the course of consultations on the review. The concerns and ideas raised during the review process which were beyond the scope of existing legislation have therefore been addressed separately in this discussion paper.

The Producer Advisory Committee of the Western Grain Stabilization program and other farm groups have emphasized that there is a growing concern on the part of grain producers that the program is not doing the job they believe it was intended to do. Both the Advisory Committee and major farm groups have requested amendments which will improve the responsiveness of the program. Producers having contributed substantial amounts in levy payments are now questioning the usefulness of this investment.

The W.G.S.P. has been discussed at some length at all of the farm meetings this winter. It is evident that there is a great deal of dissatisfaction with the level of support provided by the program and a strong feeling that the program must be improved to make it more sensitive to current financial conditions being experienced by prairie grain producers. A selection of resolutions passed at annual meetings this winter are shown in Annex I.

The Western Grain Stabilization Advisory Committee met in September 1983 and was of the view that the need to make the program more responsive is urgent to its continued acceptance and success. The recommendations of the W.G.S. Advisory Committee are presented in Annex I.

In recognition of the concern that changes to the program are needed to make it more sensitive to the current financial situation prevailing in the farm sector, and the widespread producer support for changes to the program, the December 1983 throne speech indicated that: "Amendments will be introduced to the Western Grain Stabilization Act to make it more responsive to the needs of producers."

CONSIDERATIONS:

1. FINANCIAL SITUATION - GRAIN SECTOR

Behind the widespread concerns in Western Canada about the responsiveness and flexibility of the Western Grain Stabilization program is the significant decline in grain prices since 1981 following a strong rise in costs. Producers are concerned that no recent payouts have been made. While still above the previous five year average, net cash flow declined by six percent in 1982 and did not trigger a payout. The average price of the seven grains currently covered by the W.G.S.P. dropped from $209 per tonne in 1981 to $174 per tonne in 1982, a decline of 16.8 percent. For 1983 the average price of the seven grains dropped to $168 per tonne, a 3.4 percent decline from 1982, but a 19.7 percent decline from the 1981 average. Combined with erosion of the purchasing power of the net cash flow due to inflation and the higher share of returns needed to cover cash costs producers are pressing for a payout. There are widespread concerns over the welfare of the sector.

The 1982 net cash flow in real terms was lower than all years but 1978 since the program started. The net cash flow for 1983 in real terms is expected to be the lowest since 1971. As a result grain producers are experiencing a real financial squeeze in that money left over after cash costs will buy considerably less than at any time in the previous decade.

Although the nominal net cash flow has not dropped below the previous five year average and has therefore not triggered a payout, a number of indicators point to a serious financial problem in the prairie grain sector. There is no single indicator of the financial well-being of Western Canadian grain producers because the degree of financial difficulty varies among farmers.

(i) Bankruptcies

The number of farm bankruptcies in the prairie provinces has increased in recent years and especially in 1983. As shown below prairie farm bankruptcies have increased each year over the past five years and in 1983 reached 154 an increase

from 78 in 1982. Looking at farm bankruptcies in terms of type of farm, the number of bankrupties for farms which were primarily crop farms was 68 in 1983 compared to 27 in 1982, while the number of livestock farm bankrupties was 56 compared to 29 in 1982.

One could relate these bankruptcies to the total number of farms on the Prairies but it would be impossible to compare that ratio with the ratio of bankruptcies in the non-farm sector because the number of businesses in Canada is not available.

Although the number of bankruptcies on the surface may not appear large, the following excerpt from the December 1983 Agriculture Canada Market Commentary - Farm Inputs and Finance - indicates the context in which these figures should be considered.

'Bankruptcy statistics do not accurately represent the degree of financial failures in the agricultural industry, because many operations which close down because of financial problems do not reach the bankruptcy court. Private sales or forced liquidation are more common problems. However, the number of farm bankruptcies is an indicator of the financial health of the agricultural industry relative to previous years'. The extent to which bankruptcy statistics underestimate financial difficulties in the agricultural sector was brought out at at a

1983 conference on 'Farm Credit and the Financing of Agriculture' at which it was generally agreed that in the spring of 1983; 2-5 percent of farmers were close to financial failure and another 5-10 percent were experiencing financial difficulty, that is, problems in meeting debt commitments and arranging refinancing.

(ii) Farm Credit-Extended and Outstanding

In recent years farm credit extended has increased each year and the total farm credit outstanding has increased. Between 1976 and 1982 the amount of farm credit extended increased by 79.0 percent, from \$5,643 million to \$10,099 million. Over the same period the total credit outstanding increased by 116 percent from \$9,359 million to \$20,232 million. Although data is not available for the crop production sector, Statistics Canada data suggests that about 50 percent of the total outstanding farm debt is in the three prairie provinces. This percentage has remained consistent since 1971 and does show that those provinces whose agriculture is heavily crop production oriented also have a large share of the outstanding debt. As the amount of credit outstanding increases, more net cash flow is required to service this debt, thus squeezing the amount of disposable income available to the producer. In 1981 and 1982,

high interest rates have accentuated the problem already faced by producers.

The number and amount of Farm Credit Corporation loans in arrears is further evidence of financial difficulties in the farm sector. In the three prairie provinces the percentage of loans in arrears on February 1, 1984 was 13.9 percent compared with 12.6 percent a year earlier and 10.9 percent on February 1, 1982. Furthermore the increase in the amount of principal and interest in arrears was much greater than the number of accounts in arrears. On February 1, 1984 the amount in arrears was 41 percent larger than in February 1, 1983 and 105 percent greater than in February 1, 1982.

(iii) Land Prices

Land prices in the prairie provinces, after having increased rapidly, levelled off in 1982, and in 1983 have actually declined in all provinces. On the basis of Farm Credit Corporation information, farm land prices in 1983 compared to 1982 appear to be about 15 per cent less in Manitoba, about 5 percent less in Saskatchewan and about 25 percent less in Alberta. The smaller decline in land prices for Saskatchewan can be explained in part by the interest subsidies offered by the Saskatchewan Farm Purchase program, a new program introduced at the beginning of 1983.

In Alberta cash rents varied widely with rates in 1983 generally lower than in 1982 reflecting the decline in land values. This same situation probably also existed in the other two Prairie provinces. In addition, in areas of western Canada where cash rents had become popular in the last few years, the trend has reversed to crop-share agreements, a more traditional method of land rental in western Canada.

A drop in land prices is indicative of a real loss of capital value or income. Furthermore, lower land prices reflect producers' view that the future earning potential of a parcel of land is likely to decline.

(iv) Farm Equipment Sales

Farm machinery replacement is currently another area facing slow demand from western grain producers. The Market Commentary again makes the following broad analysis:

In western Canada, machinery sales also declined from year earlier levels. This occurred despite strong marketings of western grains, which are largely offset by weaker Canadian Wheat Board initial prices and a 20 percent drop in 1982 realized net

farm income. Thus, farmers have continued to be reluctant to purchase new machinery. As a result, unit sales of tractors, combines and balers are estimated to have declined 8, 16 and 6 percent respectively in 1983 from a year ago. A note of caution is that the period 1979-1981 was a period of high capitalization of farm machinery. Thus in the following period one would expect machinery purchases to decline.

The following table gives the national unit sales for three types of machinery primarily used by grain farmers in western Canada:

MACHINERY SALES (UNITS)(1978 - 1983)

	Tractors	Combines	
	4W.D.	P.T.	S.P.
1978	2756	2022	4800
1979	3255	3050	5030
1980	3691	2930	4077
1981	4338	2478	4915
1982	3201	1789	3796
1983 (estimated)	2291	1683	3244

It is clear that sales for 1982 are lower than the previous years and in 1983 are considerably lower again. In all cases, unit sales are lower in 1983 than in any of the previous five years.

The above four indicators suggest that farm income is down and are indicative of the financial difficulties being experienced.

2. GRAIN PRODUCERS' SUPPORT OF THE PROGRAM

(i) Participation of Producers in the Program

There is no recent data to indicate directly the overall popularity of the program because after the first three years in the program, farmers cannot opt out of the program. During the first three years of operation, existing producers had the option of withdrawing from the program. About 75 percent of eligible producers decided to remain in the program. However, new Canadian Wheat Board (CWB) permit holders do have the option of not remaining in the program as all new permit holders are at first automatically included in the program. In the past three years about 80-85 percent of the new permit holders have elected to remain in the program. As a result the percentage of eligible producers in the program has increased over time.

(ii) Voluntary Submission of Levies

Most of the WGSP levies are collected by the designated purchaser when the grain is marketed. However, there are a number of designated purchasers who do not collect the levy, but who are required to submit sales data to the WGSP administration. In these instances, producers can submit the necessary documentation of such sales along with the associated levy to the WGSP administration. In so doing, producers can maintain their coverage as high as possible under the program. A sharp increase in voluntary remission of levies occurred for 1983, as levies collected were almost three times as large as voluntary levies collected for 1982. This increase indicates that producers value their level of coverage under the program. However, 1983 was the first year in which an interim statement was sent out to producers in the fall to encourage them to make voluntary levy contributions to the WGSP before the January 15, 1984 deadline.

(iii) Maximum Eligible Receipt Level (MERL)

Producers have consistently asked for increases in the MERL. If there was general dissatisfaction with the program, producers would not likely ask for increases in coverage under the program since higher levies would be paid by those with receipts at the maximum level.

(iv) Demands for Expanded Eligible Participation

Many producers have requested that farm wives be eligible producers under the program. Although this change would increase the coverage for a husband and wife farm operation, it would also represent a larger financial commitment on their part to the program in terms of increased levy contributions. Others have indicated that certain types of landlords should be eligible for the program such as retired farmers and widows.

(v) Producers' Acceptance

Information available indicates that the majority of the farmers wish to maintain their participation. These farmers perceive that the program protected them from uncertainty by assuring them security, a fair return and price and income stability.

3. FACTORS LIMITING EFFECTIVENESS OF THE PROGRAM

(i) Period for receipt measurement

The program responsiveness is affected by the fact that the W.G.S.P. operates on a calendar year basis whereas the basis

of grain pricing is a crop year. This masks some of the variability in producers' income. Analysis suggests that gross revenue from the seven grains covered under the grain stabilization program is more variable when aggregated on a crop year basis than when aggregated on a calendar year basis. Over the period 1960-1981 the mean of the yearly percentage change in calendar year receipts was 13.2 percent with a standard deviation of 18.8 percent while the mean of yearly percentage change in crop year receipts was 14.7 percent with a standard deviation of 30.9 percent. A major part of grain income is realized on sales through the Canadian Wheat Board. On Canadian Wheat Board grains producers are paid through initial and final payments. Final payments are always paid in January following the end of the crop year. If grain prices are declining, a large final payment in January holds up grain income for the entire calendar year, that is for seventeen months after the end of the crop year. On a crop year basis a large final payment would affect income only for twelve months, after the end of the crop year. If a lower final payment say in January 1984 were sufficient to trigger a payout, it would be for 1984 on a calendar year basis and 1983/84 on a crop year basis.

The final calculation for 1983/84 crop year could be made in October 1984 when the cost data for 1983 is available, that is at the same time that the final calculation could be completed for 1983 calendar year. The final calculation for 1984 calendar year could not be made before October 1985 when 1984 cost data becomes available. In addition, the program on a calendar year basis includes parts of two crop years and thus if initial payments are changed from one crop year to another such a change is averaged out under calendar years. Thus under a crop year approach the program would be more responsive in that support would be provided to producers about six months earlier than under a calendar year program if an interim payment is made in March and twelve months earlier if the payout is not made until the final calculation is completed in October.

In addition it would be logical to compare crop year receipts to calendar year expenses to determine net cash flow. While some may question whether such a measurement would be consistent with accepted accounting and financial practises, such a change would link the costs incurred in producing a year's crop with the receipts realized from the sale of that crop. It would also appear to be more similar to the procedure for measuring costs that are applied against average prices under other stabilization programs.

The Producer Advisory Committee in their recommendations indicated a preference for the use of the crop year as the receipt measurement period.

(ii) Length of Base for Support

The House of Commons Standing Committee on Agriculture and the Producer Advisory Committee have requested that the Government consider the advisability of shortening the length of the base of support from the previous five year average to the previous three year average of net cash flow.

The length of time net grain proceeds would have to fall before a stabilization payout is triggered is related to the length of the base against which net cash flow in a year is compared. Under a stabilization program which supports net cash flow at the level of the previous three year average of net cash flow, stabilization payments are triggered in earlier years when net cash flow declines and payouts are larger in the earlier years. On the other hand shortening the base for support to a three year period, results in support tapering off sooner if there is a protracted period of low net cash flow.

(iii) Increasing Volume of Marketings

The W.G.S. program is unique in terms of stabilization programs in that the program accounts for variation in both prices and volumes of grain marketed. However, since 1976, the volume of grain marketed has increased each year. In 1983, the increased volume of marketings has more than offset lower average prices. Grain producers in examining the support that is afforded by the program have been critical that even though prices have declined for two years in a row and are at low levels, the program is not making payouts.

The target for grains and oilseed exports of 36 million tonnes by 1990 has been generally accepted. This would imply however that volume of marketings is going to continue to trend upwards and over the next decade could continue to reduce the sensitivity of the W.G.S. program to reductions in prices.

It has been suggested that this effect could be diminished by adjusting the level of net cash flow support for the trend of increased production. The effect of this proposal would depend largely on the selection of the base period for the production trend.

To some extent producers' concern that the lower prices have not resulted in payouts even though the mechanism under the Act does not indicate that a payout has been necessary reflects the fact that the program does not guarantee net cash flow of individual producers, even though some producers may not have shared in increased marketings. The Canada Grains Council has proposed that the W.G.S.P. be replaced by a program that responds

to the situation of individual producers. The Council's proposal would guarantee individuals a given price and a target volume. Such a proposal would be a major departure from the W.G.S.P.

(iv) Costs included in the Gross Grain Expense Data

The W.G.S.P. Producer Advisory Committee requested that interest costs on equipment purchases be included as an allowable expense. Resolutions passed by farm groups also indicate that farmers would like to see additional cost items included in the gross expense data and in particular interest costs on machinery and equipment.

The House of Commons Standing Committee on Agriculture has asked that the Government consider the advisability of including all costs allowed under the Income Tax Act with the exception of an allowance for capital costs.

The underlying rationale for an income stabilization program like the Western Grain Stabilization Program is that instability is a short-run phenomenon. Therefore, the program should ensure that revenue is sufficient to cover cash costs and to keep producers solvent in the short run, but should not interfere with long-run adjustments in market forces by guaranteeing a return to fixed assets. Thus, the objective of the program is to prevent the depletion of farm operating capital during the periods when margins over cash costs of production are too low to keep the farm businesses viable. The program is not to interfere with production decisions which are left in the hands of farmers who make their own planting and livestock production decisions in line with expected market returns.

The Net Cash Flow approach to WGSA assistance is based on the view that cash costs of production must be met, that is, cash expenditures on purchased inputs used in grain production. However, capital expenditures on land, buildings, and machinery are not covered under the plan. The cost of land is excluded because the value of land, and therefore any financial burden with respect to it, is a function of long-term profitability of either cash grain or livestock production. Expenditures on buildings and machinery are also the result of long-term investment decisions, and excluded for the same reasons. To insure that the stabilization plan does not interfere with orderly long-term resource allocation, (ie. decision to replace or augment capital assets) those costs associated with investment in building, machinery and land were deliberately excluded from eligible cash expenses. It can be argued that costs for machinery and equipment purchases which must be replaced on a regular basis represent cash costs as compared with capital costs for land and buildings. However, costs such as operator's

labour, and return to equity were also excluded because guaranteeing these kinds of costs (or returns) would also clearly interfere with orderly production response. Costs related to fixed assets are not normally included under Government stabilization programs because program benefits over time would become capitalized in the value of fixed assets and lead to a cycle of ever rising support levels and capital asset values.

4. OTHER CONCERNS

There are some concerns with regard to participation under the program.

(i) Spousal Participation

The existing provision which prohibits participation by spouses even if they are operating under a corporation or partnership is discriminating against individuals who are legitimate partners but married to each other since other family members involved in a partnership may participate in the program as multiples. An amendment to allow both spouses to participate in the program, would remove this discriminatory provision and make the program consistent with changes proposed for the Prairie Grain Advance Payments Act, but could add some cost to the Federal Government through higher producer levies.

(ii) Option to withdraw from the Program

The compulsory nature of participation for producers who did not opt out of the program during the first three years has been criticized by many producers. An amendment to allow participants an option to withdraw from the program once every ten years would increase flexibility and allow producers to decide whether the program meets their individual needs. Payouts before 1986 may be large enough to discourage producers from exercising the withdrawal option. Conversely if the program is not improved in line with producers' expectations, producers could withdraw to indicate their dissatisfaction. A large number of opt-outs and a decrease in participation could jeopardize the capability of the program to contribute to the stability of the Prairie grain sector.

(iii) Adjustment of Levy Rate

The formula for determining a change in levy rates compares interest earned by the W.G.S. Fund with levies collected. There is a concern that the current provision for changing the producer levy rate and the Government contribution does not respond quickly enough to a build up in the Fund balance. The amount of levies collected and Government contributions bears no direct relationship to payouts from the

Fund. Levies are calculated on gross receipts but liabilities on the Fund relate to net cash flow.

(iv) Variable Maximum Eligible Receipt Level

The compulsory nature of participation after each producer's first three years of participation has concerned some producers who are locked into the program. The effect of the W.G.S.P. would be limited if participation was totally voluntary. One approach which could increase flexibility of participation without jeopardizing the program is to allow participants to periodically select their own maximum level of participation. Various levels of maximum participation, e.g. $25,000, $50,000, $75,000, $100,000 per producer could be allowed with each participant choosing a level for a five year period. The maximum level that would be chosen could be set at the level that would cover 90 percent of grain receipts if all producers were covered by that maximum. Participants would continue to share in payouts in proportion to their levies relative to all producers' levies. A drawback to this approach is that producers may elect to have a low maximum level of participation. At a time when financial assistance is required this could then result in requests for additional ad hoc assistance. If total producer coverage under the W.G.S.P. declined as a result of the increased flexibility of participation then the Government contribution would decline in relation to lower producer levies.

(v) Amendments for Housekeeping

Since the program was established in 1976, the need has arisen to modify some clauses of the Western Grain Stabilization Act to better reflect the intended meaning or operational procedure.

OPTIONS:

Three alternative approaches to addressing the two major issues have been developed. These would involve a change in one aspect of the basis for calculating support under the program which could strengthen the program and address factors limiting the sensitivity of the program.

The options are:

(1) A change in the length of base of support from the previous five year average to the previous three year average.

(2) A change in the period for measurement of receipts from calendar year to crop year.

(3) Inclusion of a secondary support mechanism on the basis of per unit net cash flow.

A fourth option, that is a levy moratorium, focuses on the issue of the size of the W.G.S. Fund and could be used with either the existing program or with any of the options or with combinations of those options.[1] A fifth option is the pre-payment of payouts before the end of the stabilization period on the basis of projected data.

I A change in the length of base of support from the previous five year average to the previous three year average

Under this Alternative the base period would be reduced from five years to three years enabling a more rapid response to a drop in net cash flow. This more rapid response occurs because the three years immediately prior to a down turn would tend to have a higher net cash flow than the five years prior to a down turn. A five year period would likely include years in which there were lower net cash flows.

Advantages

1. Stabilization payments are triggered more quickly and are larger than under a 5 year basis when net cash flow declines. Thus a three year average base would place cash into farmers' hands earlier in the downturn than is the case for the existing program. Under the current program, large payments associated with the bottom of the downturn were not made until recovery was already under way, because of delays in calculation of payouts. Although a similar delay will occur under a three year base, the larger and earlier payments would offset to some extent the delay. This was the case in the period 1976-1979, where the largest payout for 1977 would have been made in 1978, the year in which producers experienced their lowest net cash flow. Under the existing program the largest payout was not paid until 1979 when net cash flow had increased.

2. The effect of a continued increase in the volume marketed, is less under a three year base than under a five year base, because the volume of marketings is higher on average using a three year base when volume is trending upward.

3. This would be a simple amendment to administer and explain to producers. There would be no changes to collection of receipt data.

Disadvantages

1. Due to the shorter base period, the three year average base is more susceptible to an abnormal year, whether high or low income and therefore the level of support is less stable than under the existing program. It is unlikely that there will be a recurrence of the dramatic increase in net cash flow such as occurred in 1974 and 1975 which triggered larger payouts under the three year basis than under the five year basis for the 1976-1979 period.

2. Support and payouts during a prolonged depression of net cash flow will decline more quickly than under the existing program.

II A change in the period for measurement of receipts from calendar year to crop year

Under this Alternative the stabilization period for receipts would be the crop year (August to July) rather than the calendar year while expenses would continue to be based on a calendar year. This alternative is proposed because the calendar year basis masks some of the variability in receipts. In the twenty year period 1961-1981 the receipts on a crop year basis were more variable than on a calendar year basis. In that period payouts thus would have been more frequent and larger when receipts were calculated on a crop year basis rather than on a calendar year basis.

Advantages

1. The final stabilization payouts would be calculated each year by October/November, that is, three to four months after the end of the stabilization period as compared to ten months after the stabilization period under the current program.

2. Because crop year receipts are more variable than calendar year receipts, when there is a decline in receipts resulting in a stabilization payout the size of the payout is likely to be larger.

3. Although costs would continue to be collected on a calendar year basis, as this is most farmers' fiscal year, there is likely to be a greater association between the expenses and the receipts in a crop year than there is between the expenses and the receipts in the same calendar year. For example the costs incurred in producing the 1983 crop were incurred in 1983, but the receipts for this crop are realized in 1983 and 1984. Under the current program for a given calendar year most of the receipts realized in that calendar year are from the sale of the crop produced in the previous calendar year.

Disadvantages

1. Under a crop year basis for support, crop year receipts will have to be mixed with calendar year expenses which may not be consistent with normal accounting practises.

2. The transition phase is somewhat of a problem in that support for a seven month period that is January-July, 1983 may simply have to be set aside. This would not be critical for a period such as part of 1983 for which there is no payout.

3. Because of changes in administrative procedures with regards to critical dates there would be some confusion, and all participants and elevator agents would have to be aware with regard to new critical dates for reporting data and exercising any rights under program. However, all parties in the grain industry currently operate on a crop year basis and therefore are familiar with the crop year.

III Inclusion of a secondary support mechanism on the basis of per unit net cash flow

Under this Alternative, the existing approach to calculation of support as specified under the Western Grain Stabilization Act would be maintained and a secondary mechanism under which stabilization payments are calculated on a per tonne basis would be added. The effect of this alternative would be to remove the impact of change in the volume of marketings on the net cash flow. Under the existing program an increase in the volume of marketings can offset to a large extent a drop in prices.

The net cash flow in each calendar year would be divided by eligible marketings to determine the per tonne net cash flow. The per tonne cash flow would be compared to the previous five year average of per tonne net cash flow. In any year in which the per tonne net cash flow is less than the previous five year average of net cash flow the stabilization payout would be equal to the per tonne difference multiplied by the eligible marketings. In any year in which this mechanism indicates a larger payout than the net cash flow, then the payout would be according to the secondary mechanism. Conversely if the net cash flow indicates a larger payout then the existing mechanism would be used.

Advantages

1. This alternative would remove the impact of continued volume increases on the gross receipts. The variability in grain prices and cash costs would more directly affect the timing

and level of stabilization payouts in that increasing volumes would not offset declining prices. In addition this option would retain protection against declining volumes through the existing primary mechanism.

2. This option would provide greater benefit to all participants and respond to their main concerns.

Disadvantages

1. This alternative would be a departure from the operation of the current Western Grain Stabilization program. When the program was introduced, the inclusion of volume was considered an important improvement from a stabilization program on the basis of prices only.

2. If it were decided that this per unit mechanism was to be the only mechanism and the net cash flow trigger was not maintained then there would not be any protection against declining volumes. This argues for the retention of the existing mechanism as well.

IV Amend the Act to allow for a moratorium on producer levies and Federal contributions

There is a perception that the W.G.S.P. is not working properly since the Fund balance is large in relation to likely payouts. There is a mechanism currently in the Act which adjusts the rate of producer levy contributions and hence Government contributions to the Fund. This provision led to the decrease in the producer levy to one and one half percent effective January 1, 1984. However, the mechanism does not adjust levies until the interest earned by the Fund exceeds one third of total levies for two years.

One way to achieve a more rapid reduction in the growth of the fund would be to declare a moratorium on producer levy contributions and Government contributions until such time that it is felt necessary to re-instate producer and Government levy contributions. The Fund would still earn interest and hence grow but at a much slower rate.

Advantages

1. This Alternative would help to address the preoccupation about the size of the balance in the Western Grain Stabilization Fund. During the period of moratorium, the Fund would only increase by the amount of interest contributed to the Fund.

2. This alternative would save participating producers approximately $50 million per year and reduce Federal Government spending by approximately $115 million per year based on 1984 levy rates. This would amount to a saving of a maximum of $900 of producers' money per participating producer per year.

Disadvantages

1. Producers to the extent that they perceive that there are financial difficulties in the sector would not view this alternative as providing any assistance.

2. They may be critical that this alternative has a greater benefit for the Federal Government than it does for producers. This may be perceived as a reduced Federal Government commitment to the Western Grain Stabilization program.

3. Although a moratorium will represent a short term saving to the farmer, if the Fund goes into a deficit or reaches a low level, levy rates in future may in fact be higher, given the levy rate adjustment provisions currently in the Act.

V Pre-Payment of stabilization payouts prior to the end of the stabilization period

Under this alternative which could be used with any of the approaches for amending the stabilization program, the payout would be calculated on the basis of actual receipts data for part of the period and projected data for the remainder of the period and projected cost data.

Advantages

1. This alternative would enable the Government to pay producers money considerably earlier than if they had to wait until the end of the stabilization period. As there is a concern that the program is too slow in meeting producers' needs, this alternative would permit a payout during the year in which net cash flow is low enough to trigger payouts.

Disadvantages

1. There would be considerable risk of making a larger stabilization payout than is subsequently justified on the basis of final data, because it is extremely difficult to project with precision gross receipts and expenses.

IMPACT ANALYSIS OF THE OPTIONS:

Estimated payouts under the existing program and the major options were assessed for the next three year period, based on the assumption that gross receipts will decline in the short term, but recover to higher levels in the mid to late 1980's. The impact of each option on payouts in the historical period since 1976 was also assessed to the extent that data was comparable. Although larger payouts would have occurred on a three year average basis and a combination of crop year and the additional per unit payout trigger, in the historical period, payouts in both these cases would have placed the Fund in deficit in its early years of operation. All options are considered actuarially sound for the future particularly given the current size of the Fund. Possible payouts during the next three years for the three major options compared with the current program are presented in the following table. It must be borne in mind that actual receipts in 1983/84 as in every year will depend heavily on quota levels and available space in elevators in the final weeks of the crop year.

POSSIBLE PAYOUTS BY OPTION

Calendar Year	Existing WGS Program	Support at 3 Year Average NCF	Crop Year	Measurement of Receipts by Crop Year	Combination of Crop Year and Additional per Unit Payout Trigger
	- millions	of dollars -		- millions	of dollars -
			1983/84	42	356
1984	111	239			
			1984/85	218	445
1985	170	149			
			1985/86	86	256
1986	135	52			

In summary on this basis over the next three year period the existing program could pay out around $416 million under these assumptions. The three year basis for support could only pay out about $440 million. Operating the program with receipts measured on a crop year basis could pay out about $346 million. The option which combines crop year measurement of receipts with a secondary per unit trigger mechanism could pay out a total of about $1,057 million over the three years 1983/84 to 1985/86. However, it must be emphasized that these are estimates and that actual results in years to come could vary considerably depending on market circumstances.

FINANCIAL CONSIDERATIONS:

The balance in the Western Grain Stabilization Fund at the end of 1983 is estimated at about $885 million. The Federal contribution for 1983 is estimated at $130 million with interest payments of $61 million. The cumulative status of the Fund from 1976 to the end of 1983 is therefore estimated as follows:

	millions dollars
Total producer levy payments	349
Total Government contribution	699
Total interest earned	204
	1,252
Less payouts	368
FUND BALANCE	884

As required by Section 16 of the Western Grain Stabilization Act, the levy rates have been reduced effective January 1, 1984 to one and one half percent for producers and to three and one half percent for the Federal Government.

Each of the major alternatives, is considered to be soundly funded on the existing basis of two percent producer/four percent Federal Government. The method of calculation of producer and Federal Government contributions will remain unchanged.

A levy moratorium would not lead to any change in the procedure for calculating a stabilization payout if support was maintained on the basis of the five year average calendar year net cash flow. A one year levy moratorium would however result in a reduction in Federal contributions of about $115 million per year based on the 1984 rate of contribution.

RECAPITULATION:

The general objective of the Western Grain Stabilization program is to protect producers against unexpected declines in net returns due to short term price fluctuations, reduced marketings and increased costs. The program protects actual producers within the Canadian Wheat Board area collectively and does not ensure stable returns for individual producers.

Under the program, payouts are made for any year in which the net cash flow falls below the previous five year average net cash flow. Participating producers receive a share of payouts based on the proportion of their levy contributions relative to levies paid by all participants. Payouts were made in respect of 1977 and 1978 totalling $368 million.

The balance of the W.G.S. Fund has increased to about $885 million at the end of 1983. Participating producers paid a levy of two percent of eligible gross receipts and the Government contributed four percent of eligible gross receipts from the inception of the program until the end of 1983. Because of the large balance in the Fund and the interest being accumulated the respective rates of levy/contribution were reduced to one and one half percent and three and one-half percent at the start of 1984.

A major review of the Western Grain Stabilization program has assessed the impacts and effectiveness of the program within the scope of the existing legislation. The review concluded that the program had a positive impact during 1977-78 although receipt of payouts by farmers was delayed because of data constraints. The Producer Advisory Committee of the Western Grain Stabilization program and other farm groups have emphasized that producers do not believe that the program is doing the job intended and have recommended changes to make the program more responsive to current financial conditions. The Agriculture Committee of the House of Commons also proposed changes to the program to make it more sensitive to current needs of farmers.

There are widespread concerns in Western Canada about the responsiveness and flexbility of the program. Grain prices on average have declined substantially in the past two years. The program has not provided any recent assistance because lower prices have been to a large extent offset by higher volumes of marketings. In addition producers are concerned about the erosion of the purchasing power of their net cash flow because of inflation and the higher share of earnings needed to meet cash costs. As a result producers are feeling financially squeezed. There are a number of indicators which support the contention that there is a financial problem in the grain sector.

Despite the fact that there have not been recent payouts under the program, grain producers generally have accepted the program. Participation has been trending upwards and there are requests from time to time for changes to permit higher participation.

The W.G.S. program has worked reasonably well but with changing market circumstances there is a need to adjust the program to make it more sensitive to the financial needs of producers. It is considered that a number of the options reviewed in this paper such as moving to a crop year basis for measuring receipts and the addition of a net cash flow per unit payout triggering mechanism would improve the responsiveness of the program without incurring significant additional costs.

ANNEX I

W.G.S. Producer Advisory Committee Recommendations and Resolutions from Farm Organizations Regarding W.G.S. Program.

The Western Grain Stabilization Producer Advisory Committee recommended that the Western Grain Stabilization Act be amended to include the following provisions which in the Committee's view would make the program more responsive and sensitive to the needs of participants:

(1) Calculation of stabilization payments using a 3-year average net cash flow base period with preference for the use of the crop year as a measurement period.

(2) An option which would allow participants to withdraw from the program after a participating period of 10 years.

(3) An option which would allow participants to periodically elect a specified level in grain receipts for levy entitlement.

(4) Acceptance of interest costs on equipment purchases as an allowable expense.

In respect of (3) the Committee suggested that participants be allowed to select their own maximum level of participation in multiples of $25,000. This would increase flexibility and eliminate adverse reactions to changes in the maximum eligible receipts level. The proposal could jeopardize the contribution of the program to sector stability if a large number of producers opted for only partial coverage. In respect of (4) inclusion of interest would require re-evaluation of the principal of not covering cost items which could affect decisions regarding longer term resource allocation.

A selection of resolutions passed by farm groups in recent months follows:

United Grain Growers 1983 annual meeting passed four resolutions regarding the Western Grain Stabilization program two of which were:

1. WHEREAS there was no pay-out for 1982 and possibly no pay-out for 1983;

   BE IT RESOLVED that UGG ask for a review of the Western Grain Stabilization's formula. The formula

should more adequately reflect current grain prices input costs and be more beneficial to the contributors.

2. WHEREAS Western Grain Stabilization has been ineffective in stabilizing Western grain farmers' income;

   BE IT RESOLVED United Grain Growers press the proper authorities to have the Act changed to be more responsible to the financial climate, or give farmers the option of opting out with their contributions.

Palliser Wheat Growers Association's annual meeting passed the following resolution:

> WHEREAS there has not been a payout under the Western Grain Stabilization Act since 1978, despite rising input costs and falling grain prices. Increased sales volumes having kept the fund from triggering, and
>
> WHEREAS farmer and government contributions have placed over $800 million in the fund with little prospect for a current payout;
>
> THEREFORE BE IT RESOLVED

(1) That interest on machinery loans be included in the cost calculation.

(2) The five year averaging period be reduced to three years.

(3) Refund all premiums prior to the current three year period that have not been included in a calculated payout.

(4) Provide a withdrawal option after nine years with premiums refundable that have not been included in a calculated payout and that those opting out not be allowed to re-enter the program.

(5) That the annual rate of inflation be included and added to the last three years of income as it relates to the triggering of the payout.

Saskatchewan Wheat Pool's annual meeting passed the following resolution regarding the program:

That the Western Grain Stabilization formula include an inflation factor and opting out clause. That the five year average be reduced to three years and that payments be computed on a regional basis rather than the C.W.B. area.